

Lenovo-IBM: Bridging Cultures, Languages, and Time Zones

An Audacious Deal (A)

Reference Number 0004/2013

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Series
Cases

"...Cultural integration is still one of the biggest challenges.... We face the combined effect of different corporate cultures and the difference between the cultures of the East and the West."

—Orr & Xing, 2007ⁱ

On Tuesday, December 20, 2005, the public learned of the departure of Steve Ward, the CEO of Lenovo. He had lasted just eight months in the position before he was replaced by William Amelio, a former Dell executiveⁱⁱ. The move came as China's Lenovo, despite its difficult start, seemed poised to become the world's leading PC maker.

Just 12 months prior, on December 8, 2004, Yang Yuanqing, who was then Lenovo's CEO, announced his intention to purchase IBM's PC division for US\$1.75 billion—an unprecedented move for a company based in an emerging market (for a timeline of the deal, see Exhibit 1). The radical deal would transform Lenovo from a company that sold exclusively in China into a major global player. Furthermore, IBM's PC division accounted for three times the sales that Lenovo earned, so the announcement seemed less like a merger and more like David was trying to swallow Goliath.

Exhibit 1: Timeline for the Lenovo-IBM Merger



The Long March from Legend to Lenovo

Prior to 2004, Lenovo had been known as Legend, a company established by Liu Chuanzhi, a graduate of the Xi'an Military Communications Engineering College. In 1984, he and a few colleagues spun off Legend from the state-owned Chinese Academy of Sciences, which provided seed money of US\$25,000 that the young entrepreneurs used to set up shop in ramshackle building in "Swindler's Alley," Beijing's electronics black market. Very quickly, Liu Chuanzhi realized that differentiation through innovation was the only way forward. The Legend brand thus developed an add-on card that allowed Chinese applications to run on English-language operating systems; it catapulted China into the PC age. For this innovation, Legend received one of China's highest honors, a National Science Technology Progress Award.

In contrast with its main competitor Great Wall, Legend was not well connected to or protected by government authorities. For example, the company was refused a license to manufacture in China. But with innovation as its watchword, Legend came up with the idea of entering into a joint venture in Hong Kong, in which capacity it would also build motherboards and PCs and thereby outmaneuver its better-connected Chinese rivals. It was not until 1990 that Liu Chuanzhi could realize his dream to build PCs in his home country though.

In 1994, Legend went public to raise capital in Hong Kong and thus be able to compete with foreign computer manufacturers, whose products had been flooding the Chinese markets since the beginning of the 1990s. Before its competitors, Legend introduced a Pentium PC in China; this first-mover advantage contributed greatly to its status as the leading PC maker on the Chinese market.

Although Legend diversified into a few noncore businesses, such as IT services, the PC business remained the center of its operations. During the mid-1990s, a young manager, Yang Yuanqing, stood out for his work in this division. An unusually bright engineer with a strong desire for clarity and precision, Yang had been hired straight out of school and, like many of the company's high flyers, had been promoted at a very young age. A forceful personality and firm believer in discipline and centralized decision making, the young Yang Yuanqing prompted descriptions such as acutely intelligent, tough, and decisiveⁱⁱⁱ, as well as autocratic in his leadership and abrasive. As an observer noted, "Yang's colleagues thought himself both strict with others and immodest about himself. For sure, he was honest and straightforward to the point of being blunt. Sometimes people were afraid to enter his office. Yang would eventually have to learn a more co-operative management style but for the moment there was no time."^{iv} Yet Yang also proved a visionary, with a sharp eye for promising innovations and new business opportunities. In retrospect, his arrival at the company was a true turning point in Legend's history.

With Liu, Yang shared the conviction that to achieve ambitious goals, Legend needed to attract China's best and brightest and then imbue them with the Legend spirit. Newcomers had to "fit the mold," and the company went to great lengths to instill the right mindset, values, and work ethic.

Legend's Vice President Du Jianhua described the desired corporate culture, as well as required changes in management practices and individual behavior, using the "1-2-3-4-5 formula":^v

- 1—Adopt one common culture and vision that all Legend employees and managers share.
- 2—Require dual attitudes from employees. That is, Legend employees were expected to treat customers with the utmost respect and care, in line with the motto, "the customer is the emperor," and go the extra mile to meet customers' needs. Legend's definition of "customers" included internal customers, suppliers, dealers, and distributors, so employees also were warned not to offend or exploit these members of the extended Legend family. The second employee characteristic the company prioritized was frugality. Every employee needed to be aware that Legend was a profit-maximizing organization, with the motto "Save money, save energy, save time."
- 3—Concentrate on three fundamental leadership tasks: build the management team, determine the strategy, and lead the troops. These tasks, reflecting the philosophy of Sunzi, constituted not only the capabilities that leaders needed to possess but also the recommended approach to managing people. Thus, management was to instill discipline and obedience in the rank-and-file staff and ensure employees strictly adhered to

company rules and policies. Only in case of an emergency or crisis that might cause severe damage to the company could employees act according to their own judgment.

4—Adhere to four commandments: (1) Don't abuse your position to line your own pockets; (2) don't accept bribes; (3) don't take any second job outside the company; and (4) don't discuss your salary with anybody in the company. These rules defined minimum requirements; employees also were expected to meet additional standards of conduct. In a management meeting in August 1997, Yang described the ideal Legend employee as follows: Accurate, careful, and meticulous when it comes to details; able to analyze the root causes of problems and come up with practicable solutions; able to effectively communicate and cooperate with others; and marked by relentless self-discipline. At Legend, such military-like discipline was strictly enforced and backed by stiff penalties for misbehavior. Only under pressure and with clear rules and accountabilities, Yang was convinced, would employees perform and thrive. Employees had to clock in and out; if they came late to a meeting, they had to stand for one minute behind their chair. If they were seen outside the office building without a plausible explanation, they had to accept a pay deduction.

5—Consider five changes. As the 20th century drew to a close, Legend's top management perceived a need to move away from hierarchical control toward a more participative style of leadership that encouraged people to take ownership and responsibility of their performance. Strict lines of authority and top-down control, Yang and Liu came to realize, would prevent Legend from responding to market needs and trends and achieving international significance. Thus the company faced the significant challenge of delegating responsibility broadly and promoting an entrepreneurial spirit, as well as leadership at all levels. Five changes in behavior and skills would be needed to implement Legend's new management model, which Yang introduced in 1998. Specifically, managers were expected to:

1. Work toward meeting goals and objectives rather than blindly following a supervisor's instructions;
2. Develop from a people-oriented into a task-oriented manager;
3. Do what needs to be done to respond to the needs of the customer;
4. Think in terms of numbers and specify concrete, quantifiable objectives to be achieved; and
5. Become more inquisitive and open-minded.

These management principles and rules aimed to impart a greater performance orientation and cultivate a culture of accountability throughout the company. They also were designed to reflect the company's core values: customer service, innovative and entrepreneurial spirit, accuracy and truth-seeking, trustworthiness, and integrity.

To instill these values, Legend's top managers decided to adopt Western-style performance management and human resource (HR) practices. It was among the first Chinese companies to introduce a stock option program for managers. It also implemented a forced ranking, or "rank and yank," system that required managers to identify the top and bottom 10 percent of performers, similar to the appraisal system introduced by Jack Welch at General Electric. This prompted some observers to conclude that Legend was not a "typical" Asian company^{vi}.

In 2001, when Yang was appointed CEO and Liu took on the chairman role, Legend also began globalizing. Yang and Liu had become convinced that growth opportunities in China were limited by the increasingly fierce competition in the Chinese market. To pursue opportunities outside China, they established a new vision for Legend, namely, to join the

Fortune 500 and become the first global Chinese player. But the name Legend was already copyright-protected outside of China, so the company renamed itself Lenovo – “Le” from Legend and “Novo” to indicate a new start. Also in 2004, Lenovo announced its decision to become the worldwide partner of the International Olympic Committee, as the computer equipment provider for the 2006 Winter Olympics in Turin, Italy, and the 2008 Beijing Olympic Games.

The IBM Opportunity: Acquiring an American Icon

IBM, an icon of corporate America, was founded in 1911 as The Computer-Tabulating-Recording Company. After its geographical expansion into Europe, South America, Asia, and Australia, the company took the new name International Business Machines, or IBM, under the leadership of Sir Thomas J. Watson Sr., the head of the organization from 1915 to 1956. A self-made man with no higher-level education, he reportedly stated: “The trouble with every one of us is that we don’t think enough. We don’t get paid for working with our feet; we get paid for working with our heads” (Forbes, 1948)^{vii}. The slogan “THINK” was thus a mantra for IBM; it was also the motto above the door of the IBM schoolhouse where all new hires, usually fresh from college, had to undergo 12 weeks of education and orientation.^{viii}

The beliefs of Sir Watson not only prompted the company’s innovativeness but also had long-term impacts on the attitudes and behaviors of its workforce. Watson emphasized impeccable customer service and insisted on dark-suited, white-shirted, alcohol-abstinent salesmen. With fervor, he instilled company pride and loyalty through job security for every worker, company sports teams, family outings, and a company band. Employees received comprehensive benefits and were convinced of their own superior knowledge and skills^{ix}.

IBM also prided itself on shaping the entire computer industry. With the advent of high-performing integrated circuits, “Big Blue”—a corporate nickname that recognized IBM’s army of blue-suited salesmen and blue logo—could launch the System/360 processors that enabled it to lead the market with high profit margins and few competitive threats for decades. This position changed with the rise of UNIX and the age of personal computing though. In 1986, IBM developed the first laptop, which weighed 12 pounds; by 1992, it was promoting the ThinkPad, the first notebook computer with a 10.4-inch color display that used Thin Film transistor technology.

Despite its pioneering entries into the PC market, IBM did not make its PC business a top priority and surrendered control of its highest-value components, namely, the operating system and the microprocessor, to Microsoft and Intel, respectively. Critics widely attributed IBM’s decline in the late 1980s and early 1990s to its failure to protect its technological lead; it became a follower rather than an innovator^x. The once-dominant giant came close to collapse when its mainframe computer business, the primary growth engine of the 1970s and 1980s, ground to a halt.

But the CEO in what were arguably IBM’s darkest hours brought the company back from the brink. When he took over in 1993, Louis Gerstner recognized that IBM’s cherished values—customer service, excellence, and respect—had become a sort of rigor mortis, which turned them from strengths into liabilities. “Superior customer service” had come to mean servicing machines on the customers’ premises; “excellence” had mutated into an obsession with perfectionism. The numerous required checks, approvals, and validations nearly paralyzed the decision-making process. Even the belief in respect for the individual

had turned into an entitlement, such that employees could reap rich benefits without earning them^{xi}.

Under Gerstner's leadership, the company was recentralized and structured around processes. He introduced global customer relationship management, a complex web of processes, roles, and IT tools that affected tens of thousands of employees. It took IBM nearly a decade to remake itself into a comprehensive software, hardware, and services provider, but Big Blue's successful strategic repositioning increased the "we feeling" and strengthened what has been described as an almost cult-like culture^{xii}.

Thus, when Sam Palmisano took over as CEO in 2002, his challenge was to come up with a mandate for the next stage in the company's transformation. His primary aim was to get different parts of the company to work together so IBM could offer a bundle of "integrated solutions"—hardware, software, services, financing—at a single price. A set of shared values supported the change in strategy and ensured consistency across the globe:

1. Dedication to every client's success.
2. Innovation that matters—for our company and for the world.
3. Trust and personal responsibility in all relationships.^{xiii}

These core values provided the basis for IBM's management system and a crucial orientation frame for its diverse workforce, which serves clients in more than 170 countries.

Along with these changes to the company's orientations and values, in 2004, it made another sharp break with its history: IBM would sell off its PC business. The move would affect 10,000 IBMers working in the PC business, which was part of the company's Personal Systems Group. Although this division contributed 13% of the company's overall turnover of US\$96.3 billion in 2004, it also incurred losses from the PC business^{xiv}.

The Great Leap Forward

When IBM announced its interest in selling its PC division, Lenovo jumped at the chance; for Lenovo, the IBM deal was a giant leap forward. It gave Lenovo access to the computer giant's technology and expertise, a foothold into the lucrative U.S. and European markets, and worldwide brand recognition.

As a well-established brand worth an estimated US\$53 billion^{xv}, IBM was globally present and enjoyed a reputation for high quality, innovation, and reliability. As part of the deal, Lenovo obtained the right to use the IBM brand name for five years. This agreement would help maintain customer loyalty and avoid the risk that customers would notice any major changes. IBM also committed to continuing to provide service for its PCs and laptops, a move aimed to dispel customers' service concerns. Moreover, Lenovo hoped to benefit from IBM's long experience in global marketing and sales. Lenovo's own sales channels were limited to China, where it maintained excellent relations with major distributors, mainly due to the organization's transparent rules and procedures. But IBM had sales, support, and delivery operations all around the world.

In addition, IBM's huge sales volume would help lower the company's component costs. In the PC industry, 70–80% of total revenues go to components, so economies of scale are key contributors to keeping costs low. Lenovo expected to realize annual savings of US\$200 million just through larger purchasing volumes. The "new Lenovo" thus could tackle price-sensitive markets, such as India, and appeal more to small and medium-sized

enterprises around the world. Lenovo estimated that these markets offered growth opportunities of about US\$1 billion^{xvi}. Finally, Lenovo extended its product portfolio overnight, immediately offering a broad range of products and services to diverse customers.

The deal also seemed to make sense for IBM. Since its reinvention in the 1990s, IBM had been moving constantly toward becoming a software and integrated services provider. In 1993, revenues from the hardware business represented more than half of IBM's total revenues; by 2004, they were less than one-third^{xvii}. With this strategic reorientation, the low-margin hardware business lost importance. In addition, IBM's PC division continued to be a source of ongoing profit drains. From 2001 to mid-2004, the unit accumulated losses of US\$965 million, which imposed a major burden on the overall organization^{xviii}. The Lenovo deal promised to stop this profit drain and pave the way into the lucrative Chinese market. Lenovo's well-developed distribution network provided inroads into China, especially those leading to new corporate customers of IBM's software and service solutions. Lenovo's existing relationships with regulatory bodies and potential corporate customers, as well as its well-established brand name, could help IBM gain footing and expand quickly in mainland China.

Thus, Lenovo-IBM would obtain a competitive advantage that its closest competitors, Hewlett-Packard and Dell, could not match. As one Lenovo executive recalled: "On paper this was pretty much a match made in heaven"^{xix}. The challenge was to make it work in practice.

Endnotes

All interview excerpts were taken from Baumeister, B. (2009), *Lenovo's acquisition of IBM's PC division: A success story of cultural post-combination integration?* Unpublished master thesis, WU Vienna, unless referenced otherwise.

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